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Google Inc. GOOG
Q3 2010 Earnings Call Transcript

Executives

- Nikesh Arora : President, Global Sales Operations and Business Development
- Jonathan Rosenberg : SVP, Product Management
- Patrick Pichette : SVP and CFO
- Eric Schmidt : Chairman and CEO
- Jane C. Penner : IR

Analysts

- Jeetil Patel : Deutsche Bank Securities
- Spencer Wang : Credit Suisse
- Mark Mahaney : Citi
- Douglas Anmuth : Barclays Capital
- James Mitchell : Goldman Sachs
- Jordan Rohan : Stifel Nicolaus
- Imran Khan : JPMorgan
- Jason Helfstein : Oppenheimer & Co
- Marianne Wolk : Susquehanna
- Benjamin Schachter : Macquarie
- Ross Sandler : RBC Capital Markets
- Jason Maynard : Wells Fargo
- Sandeep Aggarwal : Caris & Co
- Youssef Squali : Jefferies
- Justin Post : Merrill Lynch
- Mark May : Needham & Company
- Brian Pitz : UBS

Transcript Call Date 10/14/2010

Operator: Good day and welcome everyone to the Google, Inc. Third Quarter 2010 Earnings Conference Call. Today's call is being recorded. At this time, I would like to turn the call over to Ms. Jane Penner, Senior Manager, Investor Relations. Please go ahead, ma'am.

Jane C. Penner - IR: Good afternoon, everyone, and welcome to today's third quarter 2010 earnings conference call. With us are Patrick Pichette, Chief Financial Officer; Jonathan Rosenberg, Senior Vice President, Product Management and Nikesh Arora, President, Global Sales Operations and Business Development.

First, Jonathan and Patrick will provide us with their thoughts on the quarter. Then Nikesh will join Patrick and Jonathan to answer your questions. Also, as you know, we recently began distributing our earnings release exclusively through our Investor Relations website located at investor.google.com. So, please refer to our IR website for earnings releases as well as supplementary slides that accompany the call. This call is also being webcast from investor.google.com. A replay of the call will be available on our website in a few hours.

Now, let me quickly cover the Safe Harbor. Some of the statements we make today may be considered forward-looking, including statements regarding Google's future and investments in our long-term growth and innovation, the expected performance of our business and our expected level of capital expenditures. These statements involve a number of risks and uncertainties that could cause actual results to differ

materially. Please note that these forward-looking statements reflect our opinions only as of the date of this presentation and we undertake no obligation to revise or publicly release the results of any revision to these forward-looking statements in light of new information or future events.

Please refer to our SEC filings for a more detailed description of the risk factors that may affect our results. Please note that certain financial measures we use on this call, such as operating income and operating margin are also expressed on a non-GAAP basis and have been adjusted to exclude charges relating to stock-based compensation.

We have also adjusted our net cash provided by operating activities to remove capital expenditures, which we refer to as free cash flow. Our GAAP results and reconciliations of non-GAAP to GAAP measures can be found in our earnings press release.

With that, I will now turn the call over to Patrick.

Patrick Pichette - SVP and CFO: Thank you, Jane. Good afternoon, everyone and thank you for joining us. As Jane mentioned, Jonathan and I will begin with our prepared remarks and then Nikesh will join us for Q&A.

In addition, and as bit of a surprise, we may actually have Eric join us for first 30 minutes of Q&A before he has to run to a plane. So, let me start by giving you some general thoughts before I get into the details of our financial performance for Q3.

At the highest level, we're very pleased with our Q3 results and it's clear that the digital economy continues to grow rapidly, a relentless trend that continues to drive continued growth in both our core business, core search, and creating market, and also for fueling momentum in our newer businesses.

Our Q3 results clearly reflect this phenomenon; that is our continued strong growth in our core business and continued very strong growth in our emerging businesses year-over-year, and indeed, we saw strength in every major product area in Q3, that is search, display, mobile as well as apps enterprise.

When I say our newer businesses are seeing great momentum, I really mean it and in that, Jonathan will back that statement up with some hard facts in a few minutes. So, stay tuned for the details.

Now, let's turn to specific of our performance in the quarter from a financial perspective. Let's move quickly through the results. Gross revenue grew 23% year-over-year to $7.3 billion. Our Google website revenue was up 22% year-over-year to $4.8 billion, with strength as I mentioned, across most major geographies and verticals. Our AdSense revenue was up 22% year-over-year to $2.2 billion, again reflecting continued strength in our Google Display Network.

Our other revenue was up 35% year-over-year to $254 million, down sequentially reflecting the end of our direct-to-consumer sale of the Nexus One. Our global aggregate paid click growth remained healthy, up 16% year-over-year and also up 4% quarter-over-quarter. Aggregate cost per click growth was up 3% year-over-year and 2% quarter-over-quarter. You should note that the FX had a negative impact on CPC growth year-over-year, but the impact for quarter-over-quarter was quite neutral. Remember too, that this is an aggregate number which includes both Google.com and our AdSense properties.

So, now turning to our geographic performance; the U.S. and rest of world are growing at a healthy pace as our results reflect, but also while the U.K. continues to lag a little bit in the economic recovery, again seen in our results. Revenue from the U.S. was up 26% year-over-year to $3.5 billion. In our earnings slide, which you can find in our Investor Relations website, you'll see that we have broken down our revenue by U.S., U.K. and rest of world to show you the impact of FX and the benefits from our hedging programs. So, please refer to those slides for the exact calculations.

International revenues accounted for 52% of our total revenue or $2.8 billion, up 20% year-over-year, which includes $89 million benefit from our hedging programs, and that compares to $39 million benefit for Q3 of last year. If we used fixed exchange rates, our international revenues would have been roughly $169 million higher year-over-year. The U.K. was up 10% year-over-year to $840 million, but actually if using a fixed exchange rate that number would have been just shy of 20%.

So, now let me now turn to expenses. Our traffic acquisition costs were $1.8 billion or 26% of total advertising revenue for this quarter. Other cost of revenue was $747 million including stock-based compensation of $8 million, and finally all other operating expenses totaled $2.2 billion, including approximately $372 million of stock -based compensation.

The increase year-over-year in OpEx was primarily due to increase in payroll, professional services and advertising and promotional spend. So, as a result of all this, our non-GAAP operating profit, which excludes the stock-based compensation increased to $2.9 billion in Q3, resulting in our non-GAAP operating margin of 40.2%, essentially the same as last year.

Headcount was up approximately 1,500 versus Q2 and we ended the quarter with approximately 23,300 full-time employees of which about 300 came from acquisition.

Our effective tax rate for the quarter was 20%, down from 24% in Q2, and this is mostly because we released certain tax reserves as a result of the settlement of our 2005-2006 tax audits, which are now completed.

Let me now turn to cash management. In the line other income and expenses, it was $167 million for Q3, which includes good progress on our portfolio management performance, although that was slightly offset by the impact of our hedging expenses associated with FASB 133. For more details on OI&E, again please refer to the slides that accompany this call on our Investor website.

Operating cash flow, very strong for the quarter at $2.9 billion; CapEx for the quarter was $757 million. Again, mostly primarily related to our data center operations and as a reminder, we continue to make significant investment in CapEx, and these have shown to be quite lumpy from quarter-to-quarter depending on when we're able to make these investments.

So in the end, free cash flow was also very good at $2.1 billion.

Before I close, I want to say a few words about how we're continuing to grow the business for the long term. When I say the long term, we really mean not the next quarter and the following quarter, but we're thinking about the next 5 to 10 years.

Looking ahead, we continue to see tremendous opportunity in our agenda in both our core and in our emerging businesses. So simply put, we're on this growth agenda at

full throttle. We're doing it largely in two ways, to think about it; continuing to invest heavily in people and also in product.

In people, it's pretty simple story, the explosive growth in the digital economy that we're experiencing it's really created a war for talent in our industry, the digital economy and one that is quite out of sync with what's happening in the rest of the economy.

So we believe this trend is only accelerated in the next 18 months and will continue to accelerate. So, in context of that, we stepped up our hiring machine and we are currently exploring how we can continue to attract and retain the very best people in this exceptionally competitive environment.

So we strongly believe that the difference between the winners and the losers in our industry, while they'll be to a large extent determined by who we can attract and who we can retain the best talent. So, to that end, we are incredibly proud to have attracted approximately 1,500 people to join Google in Q3, the majority in engineering and sales once again.

On the product side, our goal continues to be to develop truly innovative products that leverage computer science to solve these incredible problems that we tackle and offer, obviously, significant ROI across a number of very large growth opportunities.

As I mentioned, Jonathan, in a few minutes, will be speaking of this great momentum our products are experiencing and as always, we're investing with discipline following the Google tradition of being generous, but frugal.

So, in summary, very pleased with our performance of Q3 across revenue, margins, cash flow, and we plan to continue to attract higher, retain the very best talent in the world wherever they are to fuel our innovation agenda.

Now is the moment for me to turn the call over to Jonathan, which I usually means that my number parts is over, but today I've actually asked Jonathan to share with you and let me emphasize on a one-time basis a few product-specific metrics that I think everybody will be very interested to hear. As a CFO, you know as I'm usually the official buzz killer, so I need to make it very clear that we will not be updating these numbers going forward, we are merely sharing them with you as a proof point of the great momentum we are experiencing in our emerging businesses.

With that, let me turn it to Jonathan.

Jonathan Rosenberg - SVP, Product Management: Well, thanks Patrick. So I think you guys can see from the financial numbers. We've got tremendous momentum in the core business but in these emerging businesses, you guys basically have to invoke your Jedi guesstimation skills to try to figure out what's going on. So, today with Patrick's permission, I hope to shed a bit more light on these businesses with some numbers that we've not shared before, but let me start with the core.

Search is more important than ever. The Internet, as you guys know, continues to explode. There's lot more websites, there's more videos, there's more images, there's more books and news, all this stuff is coming online. At the same time, more people are coming online too, and what did these people do when they get online?

The first thing they usually do is search. So, search is still at the heart of the web, and with all of this new content coming online, doing search well is even harder than ever. I actually believe search remains one of the most challenging computer science

problems of our generation and probably the next one as well. This is why we're so incredibly proud of Google Instant.

Many of you guys speculated that we launched Instant to make more money. Well, let me tell you that's simply not the case. We launched Instant because it's so much better for the user. In fact, from a revenue standpoint, its impact has been very minimal and from a resource standpoint it's actually pretty expensive.

So why did we do it? Well, we believe from a user standpoint, Instant is outstanding, and the data that we're seeing actually bares this out. We took something that no one thought was a problem, and we created something that once you use it you can't recall how you lived without it before. It saves about two to five seconds per search and users absolutely love it. The percentage of people who select Instant results before they finish their query is steadily rising. So, in other words, that means the more they use it, the more they like it.

So, let me be clear that Instant wasn't based on a narrow financial calculation. We launched it because we could and because it's great for our users as we've always said. Of course, I know it's an earnings call, so let me be clear on another point. We do, in fact, care about money. Search is still the most monetizable moment on the web, and as search gets better, our ads have to keep pace. The good news is they are.

It turns out, we also have a lot of great momentum with AdWords and this is particularly true with the new ad formats. On past calls, I've talked about making ads more useful with the new formats like Sitelinks, and ads with the seller ratings and product listing ads, which we could see now are starting to have a real impact.

These ads appear on the more than 10% of the queries where we show ads and people like them. We see this because click through rates are up for some formats as much as 10% and up more than 30% on some others.

We're also seeing great momentum in our newer businesses, and this is where Patrick is letting me give you some big numbers. So, I hope you'll find them useful. The numbers all begin with the letter B, and remember as I often remind my team at Google, a billion is a thousand million.

So, the first big number, $2.5 billion as in display is on annualized run rate of over $2.5 billion. So, that's non-text display, meaning it doesn't count text ads running on our network. What it does count is YouTube ads, non-text ads on the Google Display Network and of course, on the DoubleClick platform.

So, you guys often ask me, Jonathan where's the next multi-billion dollar business after search? There's your answer. Its display and it's already here clocking in at over $2.5 billion run rate. So, clearly we're firing on all cylinders in display. The advertisers are running great branding campaigns. The Ad Exchange is taking off. We're partnering very well with the agencies and of course, more publishers are making more money.

If you want to know more on the display front, Nikesh who is here, is passionate about this business. He has made enormous strides with the sales force and clients, which I am sure, he'll be happy to talk to you guys about in the Q&A.

So, second big number, 2 billion as in YouTube, is monetizing over 2 billion views per week, that's up over 50% year-over-year and when you think about that growth, it's important because the RPMs are really strong on YouTube.

We've just launched some new ad formats called TruView, where the viewers get to choose which commercials to watch or they can even skip watching the ad all together. It turns out when advertisers only paid for the commercials people watch, we discover the ads are a lot more valuable to advertisers, when they are only paying for viewers who have actually chosen to watch them.

Finally, they are big number, 1 billion. Mobile is on an annualized run rate of over $1 billion. This means that people who are accessing our products and services through their mobile phones are adding a $1 billion annually to our existing revenue streams. Clearly, this is the future of search in the Internet, more people in more countries, coming on line from these smartphones.

Our mobile search queries have grown five times over the past couple of years and of course, a lot more of those queries are now coming from Android phones. So they are the facts that Patrick has let me say just this once; non-text display $2.5 billion run rate, YouTube, 2 billion monetized views per week; and Mobile, over $1 billion added to our business.

Patrick, maybe, I'll ad-lib on one more fact here without asking you, you should know, all these businesses are growing. So, I hope this gives all of you a sense of why we're so excited about the incredible emerging businesses at Google.

With that, I'll take it back to Patrick.

Patrick Pichette - SVP and CFO: Thank you Jonathan, before we take your questions, I just want to add one fact regarding the new disclosures, Jonathan, just gave you. Obviously, this information reflects our revenues from two different angles of our business. With it, we've recognized in some cases, some small overlaps.

So, for example, the AdMob revenues are obviously, included both in the Mobile number, because it's a mobile product and in Display, because it's also a display product. So, these are very small, but I wish to just clarify it out for everybody.

So, with that in mind, what I like to do is turn it over to Connie to open – and we have Eric with us, so, the 'may' is now in actual, Eric is with us, he's got 20 to 30 minutes, then he is running for a plane. So, delighted to have you with us, Eric, and what I'll do is, I'll turn it to Connie for the Q&A questions period. Thank you.

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Operator: James Mitchell, Goldman Sachs.

James Mitchell - Goldman Sachs: I'll ask three separate questions if I may. First one, if I look at your paid-lead growth, it's been remarkably consistent and not decelerating, I think it was 4% sequentially in the third quarter of 2008, 4% sequentially in the third quarter of 2009, and then 4% sequentially in the third quarter of 2010 Is that because your query growth is also fairly consistent, or are you supplementing query growth with monetization initiatives that increased paid-lead take up? Secondly and separately, thank you extremely much for disclosing the billions in terms of Mobile and Display advertising. But within the 2.5 billion plus of display advertising, how do you account for advertisers spending through the DoubleClick Ad Exchange, is that on a gross or net basis?

Jonathan Rosenberg - SVP, Product Management: I'll try to take the first question. Certainly the highest correlation between ad clicks and anything else is query growth. So, that's going to certainly by far dwarf any other factor. I think the

other factors that we are seeing is that, the new formats that we have which I'd mentioned, certainly drive click growth as well, and I mentioned that those formats appear on 10% of the queries. If you try some of those like, Halloween costumes, you will see that they make the ads much more compelling, as do things like, merchant ratings, if you type in laser printers. So, by improving the ad formats we are increasing the relative number of clicks, because the clickthrough rates go up.

Patrick Pichette - SVP and CFO: On the other one, the Ad Exchanges included in. So, if you think of the elements, the Ad Exchanges, the DoubleClick platforms, so, all these are included in Display and it's done on gross basis.

Operator: Spencer Wang, Credit Suisse.

Spencer Wang - Credit Suisse: I guess since you guys are sharing some numbers this time, I was just wondering if we could just delve into the YouTube numbers a little bit. Of the 2 billion views, Jonathan, I was wondering, roughly what percentage of total views is that currently? Then you guys have talked in the past about getting closer and closer to profitability, I was wondering if you could just give us a sense of where you are with respect to profitability as well?

Patrick Pichette - SVP and CFO: So on profitability, let me jump on that one first which is, we have not made any comments on it. You will remember we talked about it a long time ago, because there was so much distortion in the market, we just thought it was okay to set the clocks properly, but since then, we have not and we'll not comment on it. On the billions...

Jonathan Rosenberg - SVP, Product Management: So there is basically two points that we've given that you can use to connect those dots. We've said that traffic that we have over 24 hours of video uploaded every minute and over 2 billion views per day. When you couple that with the 2 million monetized views per week, I think you can get to the answer that you are looking for.

Operator: Imran Khan, JPMorgan.

Imran Khan - JPMorgan: So I have a question for Eric, as he is on the call and then I'll follow-up housekeeping question. So, Eric, I think the two big trends on the Internet, obviously the web is becoming more social and real time, so as the web becomes more social and real time, how does Google compete in that world in terms of real-time search market and how does that impact your business? Secondly on the mobile trend, obviously, you have this Apple ecosystem with Apple applications and people are going directly to applications and how does that impact Google's business model over the long term? The housekeeping question, near-term question, the tax rate was 20% on the quarter, is there anything specific in this quarter? How should we think about the tax rate?

Eric Schmidt - Chairman and CEO: With respect to social and real time, we use complex signals to do ranking and over time, we will add additional social, if you will, ranking clues. Fundamentally, we want to make search more personal and as we get more information about who your friends are, we can make the search that much better. We are quite convinced that that produces better search results for people who choose to give us that information. For people, who want to continue to do what is generally known as anonymous search, that's also possible. To one of the ways to think about that is that we want users to be more logged into to Google, the more logged in they are, more likely we are going to buy them, not only the social problem but the other information. You also asked about real time, we already have significant

feeds from real-time information providers. We have real-time index, which of course, is very successful for us and you could see that whenever anything interesting happens, it is already right there at Google. For example, we use Twitter as a real time source of information. So if you search for almost anything, you will see that Twitter feeds now is part of universal search. Could you repeat the second part of your question for me?

Imran Khan - JPMorgan: Second one was, Eric, on the mobile front, right. We are seeing explosion on application on mobile platforms, so does that impact your search volume as people go directly to the vendors through the app? This seems like Amazon talked about $1 billion sell through coming from mobile devices, how does that impact Google's business long-term?

Eric Schmidt - Chairman and CEO: Doesn't seem to. This is one of those sort of worry word questions that we get all the time, that the success of one thing could that impinge on something else and in fact, the rising tide lifts and all those. I would say that again, what I hear is this sort of presumption that it's a zero-sum game and that one wins and another one loses. What's really happening is that all of the companies that are driving the web and web applications are all doing really well. People are moving from offline to online and in the course of doing that they are using these systems more. They are searching more, using apps more, et cetera. Now, from our perspective, you have this phenomenal success of Android, which is well past anything that I had ever hoped for, and looks like it's on its way to being a huge, huge success with a number of partners, number of devices, an open model for access, lots and lots of innovation, more dynamic, more competition than any other part of the platform. There are up to 90,000 applications on Android growing very, very fast. Those applications, of course, have search services inside of them. So, we don't see them as a negative, we see both as very strongly positive.

Patrick Pichette - SVP and CFO: Let me go back then to Imran to the tax question. We did get a one-time benefit this quarter on the tax side and it is related. As the statutes expire for 2005 and 2006, all of our taxes are now closed and in doing so then we had an opportunity to reverse a set of provisions we had taken that we ultimately didn't have to take. So, you can see the tax rate this quarter is bit of anomaly again.

Operator: Justin Post, Merrill Lynch.

Justin Post - Merrill Lynch: Just when you think about Android as an operating system, how does that proprietary to Google when you think about your search services. Does that give you an advantage over other phones for some of your services and does the phone operate better when you are using Google Services? Second, I think you were quoted in a article saying, maybe someday Google can make $10 per phone, would you see that as mostly advertising and is that number right, something you did say?

Eric Schmidt - Chairman and CEO: The latter when I made out of thin air. So, we don't really have a notion of exactly what it is, but it's probably pretty big. So one way to think about Android is that it's probably the largest single platform play available in the market today, because it's a platform for computation for location, for everything that you could do with the new and most popular set of computing devices that are emerging. That market is larger than the PC market, and the Tablet market is a small component of it, but an important part of it. So if you think as Mobile as platform as phone plus Tablet plus all the other things, we hope to become the

leading platform in that space, and we are doing it with open source approach. So, in the open source approach that means, we give the software away, which is always paradoxical, people say how do you make money from that. Well let's start with the fact that the evidence we have is that the people who use Android, search twice as much as everything else. So, clearly there is more revenue associated with those searches. Other thing, of course, is if they are using Android systems, the revenue that we share and the searches are shared with the operator, but not with anybody else. So, again, it's more lucrative. So, not only is there more searches, and there's more ads, but it's also more lucrative. So, on that basis alone, Android is hugely profitable and we maintain the anti-fragmentation and other things by a series of contracts around their store and so forth and so on. So, Android is likely be financially successful to Google, without even any of the applications that are possible. So, Patrick calls up and says, okay, what else can you do for us, and the answer, of course, is that we can layer on value-added service, is usually how you get to the $10 and the value-added services could be of any kind. Our primary purpose right now is building this open platform. Google had chose to make it that on open systems and open platforms and open web; that served us well so far and it looks like it is going to work really well on Android.

Operator: Mark Mahaney, Citigroup.

Mark Mahaney - Citi: Two questions, sequentially, is there something that you have been able to put in place that gives you confidence that that will continue going forward? Just on the Mobile revenue opportunity, are the results strong enough from your perspective in terms of dollars and growth such that you'll stay with an indirect monetization approach towards Android or are you going to keep the door open and potentially charge per operating system as a share of applications in the future?

Patrick Pichette - SVP and CFO: On cost per employee look, its just another reflection of, I wouldn't read anything kind of forward-looking into our results, except that, its just another good example of how we are – I have talked earlier about generous but frugal, we're investing, but people shouldn't confuse the fact that we're investing and we're investing aggressively where we really see fantastic opportunities from being wasteful. We're just not a wasteful company, and so in that sense, it does look as a good signal and we'll continue to do so. On the Mobile, maybe Jonathan or Nikesh can give us a indication of it?

Nikesh Arora - President, Global Sales Operations and Business Development: I think just following up on what Eric said earlier, we are very, very keen to build this Ecosystem and I think Jonathan's disclosure on the fact that we're on $1 billion run rate in Mobile, is testament to the fact that, now we have a revenue model, which we are very excited about, and that revenue model sort of proves to us that, roughly the revenues are split between our search efforts, our display efforts and our application efforts. We are able to play across all those three spaces with our mobile monetization efforts, and the more people who use smartphones, the more people who are able to access (throughout) on their devices, the more we see the trend that people are going to search in them, they're going to give us opportunities to put display advertising on them. So, we see no reason to change our monetization model. We think the current approach to Android drives more users and more as usage and drives the Ecosystem.

Patrick Pichette - SVP and CFO: Nikesh, I think you've argued that display will become a very large component of the mobile revenue, because of the success that we're seeing in our mobile users and the hockey stick they are in.

Nikesh Arora - President, Global Sales Operations and Business Development: Exactly.

Operator: Douglas Anmuth, Barclays Capital.

Douglas Anmuth - Barclays Capital: Two things, first on Display. Can you give us some context in terms of breaking out YouTube AdSense for content in the Ad Exchange? Secondly, what's your view on other potentially competitive Android app stores that are out there?

Patrick Pichette - SVP and CFO: So, I'll answer the first and then I'll give Jonathan to talk about the Android marketplaces. So, on Display, we just don't break it down. So, we will not give the details. What we wanted to give today with the numbers we're sharing is a sense of scale and trajectory, and that's really what we wanted to share. So, we unfortunately won't give any more details on that. On the Android competitive stores, Eric, maybe you can give us more perspective on it?

Eric Schmidt - Chairman and CEO: The goal of the stores is to make money for the people who are writing the software in their applications, and it's not a revenue goal for Google. So, there certainly will be multiple stores, they will certainly be the key one from us, and we think it's a net win for everybody, but it's not a primary focus from Google from a revenue perspective. It's really for the developers.

Operator: Brian Pitz, UBS.

Brian Pitz - UBS: Would you provide us with a relative idea of how the difference between average CPCs and clicker rates are basically on mobile versus the PC, now that you have a large enough number of devices in the market? Secondly, if there is a gap which I imagine there is, can you close that gap longer term between the two?

Jonathan Rosenberg - SVP, Product Management: Nikesh, can maybe give you more of a customer-based perspective. I think that some of you know we've recently started smart pricing on the mobile devices, and it is the case that the CPCs on the mobile devices are good bit lower. It's primarily because there isn't the measurement, there isn't as much of consummation of a transaction on the mobile devices. People don't have their credit cards in them. It's harder to type into them. So the mobile rates remain relatively lower. As payment platforms get built into the mobile devices and as people are more likely to actually complete the transaction, I think you'll see those things go up substantially. I think it's also the case that on devices like the iPad, the kind of activity looks a little bit more like it does on a PC, primarily because people have a larger window, a bigger browser and they are also more able to input information. Nikesh?

Nikesh Arora - President, Global Sales Operations and Business Development: I think the only thing I have to add to that is there are some formats, which we started to introduce, which are driving a better monetization on the mobile sites, formats like Click to Call and hyper-local, because people are searching in their mobile devices where they want to then make a phone call or they are searching on their devices when they are looking for something in a very local context and there we're beginning to see sort of better CPMs and better monetization. Generally, we think that's where the trend is, that's where we're going to see more and more monetization, and clearly, we are seeing monetization in the application side of the mobile, because with the AdMob sort of team that we have and all the advertisers who want to be part of the application, the applications are becoming a big share of people's mobile usage.

Operator: Ross Sandler, RBC Capital Markets.

Ross Sandler - RBC Capital Markets: There are two quick questions. First is, you guys have discussed the cannibalization topic before between smartphone and PC, but when you look at the search data, can you see whether tablet searches or iPad searches are incremental or are there any cannibalization towards PC and is the tablet option within AdWords going to be similar to the desktop laptop option or is it going to be kind of a separate category? Then the cash, can you just give us a little bit more color on the rest of world growth, just in terms of regions that we're driving that 26%. Was it broad-based or was there anything that stood out?

Jonathan Rosenberg - SVP, Product Management: So we don't see cannibalization. We tend to see mobile is very complementary to the desktop. I think you do see some differences in the search patterns. People use mobile at lunch. They use it in the evening. They use it on weekends. They use it more on holidays, but we see more mobile and web search traffic growing and they appear to us to be complementary and not cannibalizing each other.

Nikesh Arora - President, Global Sales Operations and Business Development: The U.S. growth was very good for us. I'm very pleased the way our U.S. team has driven the revenues sort of across the board, across our revenue categories. On the international side, I'd say generally, the trend has been positive across the board. I know the U.K. has been a bit weaker, but there is a bit of currency in there as well. But France, Germany, and those markets have actually been very, very robust. I'd say Southern Europe has done way better than some of the Northern European countries, but that's expected because they are enjoying (similar) growth curve, and clearly some of the Asian markets are growing robustly for us. So good growth across the board.

Operator: Jeetil Patel, Deutsche Bank Securities.

Jeetil Patel - Deutsche Bank Securities: A couple of questions. I guess you're on a pace of doing about $30 billion or on gross revenue run rate. I guess maybe a different way to look at your business. But since it's an ROI-driven model, I guess can you quantify or give us a sense of what kind of gross dollar value of transactions that entails for all the merchants and customers that are participating in the system? Second, I guess if you look at your competition in mobile or in other company in this space in mobile, they make about $300 in operating profit per handset sold. I guess, do you think this is more the upper bound as it relates to lifetime profit for handset? Do you think it can be higher? I know obviously you're going after a different strategy, but where do you think is the upper-bound in terms of the profit potential on a – let's say, to your handset in terms of monetization?

Patrick Pichette - SVP and CFO: On the gross value, rather than to try to give you more details on this call, Google has actually published some economic data about the amount of value that is actually transacted across the system, and so, I may just refer you back to the IR team that can actually dig that out, because we actually shared that with the public over the last kind of eight months or six months, and it's actually very detailed into how much economic is actually flowing to our systems.

Eric Schmidt - Chairman and CEO: On the handset question, which you asked, I understand the question that you are asking. Our model, remember is that the handset manufacturer is in the operators are going to make a lot of that money. Our model is that, our operating system is free and that we're going to make money from advertising and value-added services on top of the Android platform. So, it's clearly

different model. So, it's not very difficult to compare the two, they are really apples and oranges. It would be I think premature for us to estimate what that would be, but if you assume that search monetization on handsets will become equivalent to PCs and then eventually exceed it, which is my personal view, then it should be highly lucrative, because those customers are using Google services, they are going use it more because they are more personal and more targeted. So, ultimately it should be a very, very strong revenue stream compared to a PC.

Operator: Jason Maynard, Wells Fargo.

Jason Maynard - Wells Fargo: Actually I had a question about social search. I am just curious about how do you capture the signal from social networks, without a relationship like you have with Twitter, where you can actually get fairly easy access to the data feeds?

Eric Schmidt - Chairman and CEO: One of things we're careful about is not to describe how our signals are actually assembled, but the answer is that there are some ways in which we can do that. We also have in development other ways in which people can give us that sort of information that can make it even more personal.

Jason Maynard - Wells Fargo: Then just maybe a follow-up for Nikesh. When you think about mobile advertising, maybe just sort of help me frame, where do you think advertisers are at in their lifecycle of actually committing dollars to spend in this medium inform factor?

Nikesh Arora - President, Global Sales Operations and Business Development: I think the important part to understand on the mobile space is that the reason the $1 billion dollar number is an interesting number that just means that now the larger advertisers can get more interested, because we can help them spend reasonable amounts of money. It's very hard to go and make a pitch to a large advertiser when the maximum inventory that you can offer them is in the five to ten or $50,000 range, especially, with advertisers who got $100 million or $200 million advertising budgets. So, to get them interested, if they get interested, they'd like to be able to deploy reasonable amounts of money against this market. So, the part I am excited about is that the inventory continues to grow. That is diversity in formats. People are interested in search-based advertising. People are interested in display-based advertising. They want to be in the middle of applications and get customer engagement. So, we are seeing sort of reasonable broad-based interest. Clearly, the early adopters are people who can actually consummate a transaction, so, insurance services want a click to call, they want to be able to pitch, they want the customer to be able to pick up the phone and call them. There are now people who are in the local space, who want the customer to come to their restaurant. They want the customer to come show up, where they are offering a local service. So, that interest is going up. Now the retailers who actually are interested when you're looking for a local JCPenney or RadioShack that, if we can tell you where it is and they can actually click and find out where it is. So, the interest continues to grow as you look at the local categories, as you look at the click-to-call categories, and as Jonathan said, as payment capabilities start getting bills into the phone, you'll start seeing even more of an interest from the e-commerce players.

Jonathan Rosenberg - SVP, Product Management: By the way, this is Jonathan. Try typing in some things that will generate the hyper-local feature that we have on mobile search ads. If you try for example, typing in car rental, there is a very good

chance you'll see an enterprise rent-a-car ad that tells you how far away it is to your nearest location. Half a mile along with the phone number and a link to a map, and I think that will give you a sense of how powerful it is.

Operator: Jason Helfstein, Oppenheimer & Co.

Jason Helfstein - Oppenheimer & Co: One of the questions that investor's continue to have, is ultimately what's the right long-term growth we have to think about for international. Prior to the recession, the Company was obviously putting up a very large international growth rate, and we've seen a slowdown and now we're rebound. Is there additional color you can give us as far as you think about the long-term opportunities, what they are in the more developing countries and how that's impacting your results internationally?

Patrick Pichette - SVP and CFO: Because it's forward-looking guidance, we just can't comment. I think that you have to take it from the current performance that you see over the last couple of quarters that there is clearly a separation in the world of economic growth in general and the digital economy growth, and from that I mean, you have to infer that that's why we're so optimistic about the future of international, and we're investing so much in it.

Operator: Youssef Squali, Jefferies.

Youssef Squali - Jefferies: Two quick questions. First, Patrick, your Traffic Acquisition Cost rate seems to be the lowest you had, I think since IPO. What accounted for that and is that sustainable going forward? Two, growth in the last few quarters was driven largely by volume, not price. So, to what extent is that driven by more SEO, less SEM, maybe a mix of domestic versus international? How realistic is it for us to kind of expect, kind of hockey stick or maybe not hockey stick, but a reacceleration in pricing trends?

Patrick Pichette - SVP and CFO: So, I'll take the first question, and then on pricing, Jonathan can probably give you some perspective. On the TAC it's very simple, I mean this quarter we've had two really factors. One is, our MySpace deal is now over and then with it, there was a contract with minimum guarantees that now has expired. So that's one (all meant and done). The second one is simply the mix of our partners within the network, actually will affect our TAC, and that's really the effect that you see for this quarter, there is nothing more of us. In terms of forward looking for volume versus price, Jonathan any insights or...?

Jonathan Rosenberg - SVP, Product Management: I am not really sure how to answer the question without saying anything forward-looking, so is there anything specific use of in terms of trends that you've seen that you are asking for clarification on?

Youssef Squali - Jefferies: We've been hearing from agencies and advertisers there that they are spending more on SEO. They are getting smarter about how to spend their ad dollars. So to the extent that that continues and that really is putting a dampening effect on CPC growth going forward. The mix between domestic and international should shift to more international and that over time we should see higher CPCs. I am just trying to kind of see as we look at the business over the next several years how realistic is it to assume that one, i.e., that increased international CPCs will offset the SEO trend?

Jonathan Rosenberg - SVP, Product Management: I guess I don't actually agree that I've necessarily seen such a trend in terms of more SEO versus SEM. As far as I can tell, SEO has always been pretty big. Pricing has been pretty healthy from my perspective coming out of the recession, bids are healthy. We've got very strong conversion rates and presumably that's because the advertisers are seeing buyers again. The advertisers look at the total value they get from Google, and they are optimizing across everything under their purview. So I am not necessarily sure I agree with the trends they way you have stated them.

Eric Schmidt - Chairman and CEO: The other thing that's going on is we're continuing to make algorithmic improvements to our ad targeting, which is flow through the system as the inventions are brought out. We've brought out hundreds of them, in the quarter the small ones, but some of them is actually helping drive basically the revenue performance in a per query basis.

Operator: Ben Schachter, Macquarie.

Benjamin Schachter - Macquarie: A few years ago, there was a lot of discussion around fallible exclusive data or databases and while yesterday's deal with Microsoft and Facebook was not exclusive, I wonder if you think that's going to be a topic that may become more of an issue going forward, particularly with Microsoft and then also just quickly, a lot of discussion lately around daily deals and private sales and those kind of things, can Google participate in that any way?

Patrick Pichette - SVP and CFO: In general, the web continues to grow at such a blazing pace that if you think of all the signals available – I mean, there are anyone that will be private is completely swamped in the sea of the Internet and in that sense. It's not really a relevant question if you can think of the, what Jonathan would call it petabyte or terabytes or exabytes, so from that perspective I think that we continue to organize the vastness of this and that's where most of the value comes from. So I think that we're concerned on that sense.

Eric Schmidt - Chairman and CEO: There's always a concern that large private collections of a data are not accessible to web search engines. We have teams that is going awful lot of time trying to make sure people know that they if they optimize (indiscernible) we have sitemaps and other services which are standardizing on the web search industry. So it's obviously up to the content owner to decide how much of that information to expose, but we've taken the position both in religious and a business perspective that the world is better off if you take information that you are assembling and making it searchable. It provides a larger audience. It drives more traffic to your site, et cetera, et cetera. We fundamentally believe that. Jonathan, you want to take the second?

Jonathan Rosenberg - SVP, Product Management: There' no question, Ben, there is very exciting space related to daily deals which we're seeing and there is obviously a lot of small companies that are doing a fabulous job there. We do participate in it. To some degree, there are some companies that use Sitelinks for hot deals. So, there is a mechanism that we already have, where advertisers are actually putting in today's deals and highlighting them. But there is no question, that's a very exciting and hot space, and there are a lot of innovative players, buildings and pretty effective business models there right now.

Operator: Jordan Rohan, Stifel Nicolaus.

Jordan Rohan - Stifel Nicolaus: Couple of follow-up questions on Mobile while we're on this subject. I am a big fan of Google Instant, wondering when it'll be fully rolled out on BlackBerry, iPhone and other devices there. Also curious, if you happen to disclose the number of Android devices activated in the quarter, I think last quarter it was around 200,000 a day? Finally, instead of smart-pricing and sort of obscuring the discount placed on mobile search, clicks or calls, why not let advertisers just bid directly on the mobile search inventory, you might be surprised about the yield?

Patrick Pichette - SVP and CFO: So, let me on Instant, Jonathan, when is Instant available for all these mobile devices?

Jonathan Rosenberg - SVP, Product Management: It's relatively soon. Sometime this fall, the fall lasts a little longer in California though.

Patrick Pichette - SVP and CFO: Last public number is 200,000 handsets activated a day, and that's the last number that we've been using, so we stick to that one for now. Can you just repeat, Jordan, your last question for me?

Jordan Rohan - Stifel Nicolaus: Smart-pricing is, as I understand and maybe I'm getting it wrong, but Google has an algorithm which discounts the value assigned to advertisers that, which advertiser have to pay for certain clicks, if it's believed that those clicks perhaps are less frequently tied to conversions?

Patrick Pichette - SVP and CFO: Yeah, they can set up a separate campaign now. So, the smart-pricing is a convenient mechanism for them, if they want to leverage the existing campaign across mobile. But many advertisers have increasingly setup separate campaigns for mobile.

Jordan Rohan - Stifel Nicolaus: They get right now full visibility there, so that's how you at some level inform your decisions about smart-pricing for the rest of the universe like that accesses is the inventory…?

Jonathan Rosenberg - SVP, Product Management: I'm not sure that's – no, the smart-pricing is done algorithmically on the basis of what we see, we're not doing it. We don't necessarily look at differentiation between specific bids across different campaigns.

Operator: Sandeep Aggarwal, Caris & Co.

Sandeep Aggarwal - Caris & Co: Actually I have two questions. One is Eric, given that non-core search business is becoming more material part of your business, in the past in 20-20-10. Is there a shift in terms of how you are allocating resources now? Secondly, this may imply more of asking an guidance, but I guess my question is, by when do you envision mobile advertising overtaking display advertising?

Patrick Pichette - SVP and CFO: The latter is a very speculative question and not something that one, we don't know and two, if even we knew, we probably wouldn't talk about it. On the question of allocation of resources, I think at the end of the day Larry talked about sort of our jobs to use our best judgment based on the sum of opportunity, business opportunity and so forth, to divide if you will, between classic core businesses, you're really asking in some of these emerging ones. So, we are informed by the hockey stick nature of these things. So, there is a couple of ones, give you an example of Android, which is small in resources and growing very quickly, so, they pretty much have been able to get whatever resources they need and they are going up against very large giants with the factor of ten more resources,

and so we sort of measured it that way. When we then go back and saw for 70-20-10, it turns out that we're roughly consistent with 70-20-10. It's not really as much of a formula, as is much looking at where the real excitement is. The other thing that we're doing is we're organizing ourselves and Nikesh is actually leading this effort into more of an internal business unit structure, because frankly, it's just become so large and so complicated that it's been difficult for us to keep track of all the details. So, that will give us a better tie in between where the current and future revenue is, and where the resources are going, and I think Nikesh is on the order of 10-15 kind of structure by the time you're done, with the obvious big ones being, search and ads and display and enterprise and that kind of stuff, YouTube.

Patrick Pichette - SVP and CFO: Closing on that, what really matters the most to us, as we actually do the resource allocation is as Eric said, when you see a hockey stick, pour on gas on that fire and when we do actually and we keep the flexibility to make sure that we really feed the winner, so, that they keep the momentum as you've seen for example in Android in the last 24 months which has been tremendous.

Operator: Mark May, Needham & Company.

Mark May - Needham & Company: Big picture question about data, because that seems to be an increasing factor of differentiation in growth for online ad companies. How does Google think generally about leveraging user data both to better target ads and how to stay competitive with those like, Facebook and Microsoft and Yahoo! that are leveraging data possibly more so than like Google is today. I think this is particularly relevant for using search data for your display business but we'd love to get your thoughts on that?

Patrick Pichette - SVP and CFO: We have a pretty strong opinion that we're not going to do very much of it. The reason is that we take our end user data privacy incredibly seriously, and the trust that people have with respect to giving us that information, both their search histories as well as other piece of information, they get very upset very, very quickly, if we in their view misuse it. So, what we typically tell people is, we're not going to do the kind of things that you could do it, thus, in particular, use to generate sort of strange apps against your history and things like that, without your explicit permission, and we probably in many cases won't do it for ever.

Operator: Marianne Wolk, Susquehanna.

Marianne Wolk - Susquehanna: It looks like you did a great job converting a lot of the advertising on the content network over to display, can you talk about to what extent that's now video-based and is that helping monetization rate significantly? Do you expect that to be sort of a 100% display shortly?

Patrick Pichette - SVP and CFO: Nikesh, maybe you want to talk about the display and how it's evolving?

Nikesh Arora - President, Global Sales Operations and Business Development: I have been waiting for the entire earnings call, Patrick, to talk about display. I am glad that Patrick and Jonathan have allowed us to disclose the run rate of $2.5 billion. I think this puts us in one of the top three display networks in the world. I also believe that the technology suite we offer is second to none. So in terms of the video versus the other display formats, it is primarily a lot of this is still display in terms of banner ads and other formats, and video is beginning to come into it. But

we believe in the future there is going to be a lot more rich media involved into display network, because as we go forward you're going to see more and more monetization of video, but that is on YouTube or other partner sites that's going to happen. So we believe the display network we offer has maximum frequency and maximum reach. We can reach people more times a day than anyone else, so really excited about display. I was not sure what you meant by what becomes 100% of display?

Marianne Wolk - Susquehanna: I'm sorry, but of the sort of roughly 1 million partners that are part of the partner network, to what extent is that now converted to display and could that ultimately be an entirely display network? Then also just since I've got you, can you clarify the run rate information you gave? Is that a trailing 12-month figure or are you annualizing the current quarter?

Nikesh Arora - President, Global Sales Operations and Business Development: So I'll let Patrick answer on how we commented on $2.5 billion dollars, but in terms of the million partners we have, the entire partner network is part of our display network that we offer, and we actually have the ability to offer them display advertising or text-based advertising, and basically it's based on ROI and CPMs that we make that determination or the publisher makes the determination or the advertisers make the determination. So, an entire network that we have is open for display advertising already.

Patrick Pichette - SVP and CFO: On the fourth question, it's just the trailing quarter. So, with that, thank you for your question, Marianne. Let me give you a couple of thoughts, one is, just want to reiterate that what we did today, was give you a few indications of why we believe we're successful in these emerging businesses. These data points are not about giving you more information on the coming quarters, but more to give you the confidence that where we're investing in is really fueling great growth rates and building meaningful businesses. I want to thank you Eric for taking the time. I know he is running for the plane, but its terrific to have you on the call and take a few minutes with our analysts and shareholders, and then I also want to take a moment to thank all the Googlers for their hard work, I mean, all this strong performance is really on the back of fantastic work from our team worldwide, our great engineers, our great sales force and our great support staff, everywhere. So, I just wanted to take from the OC, just the time to thank them again in the public domain because they do such a terrific job. With that Connie, I'll let you close the call.

Operator: Thank you and this concludes today's conference. We thank you for your participation.